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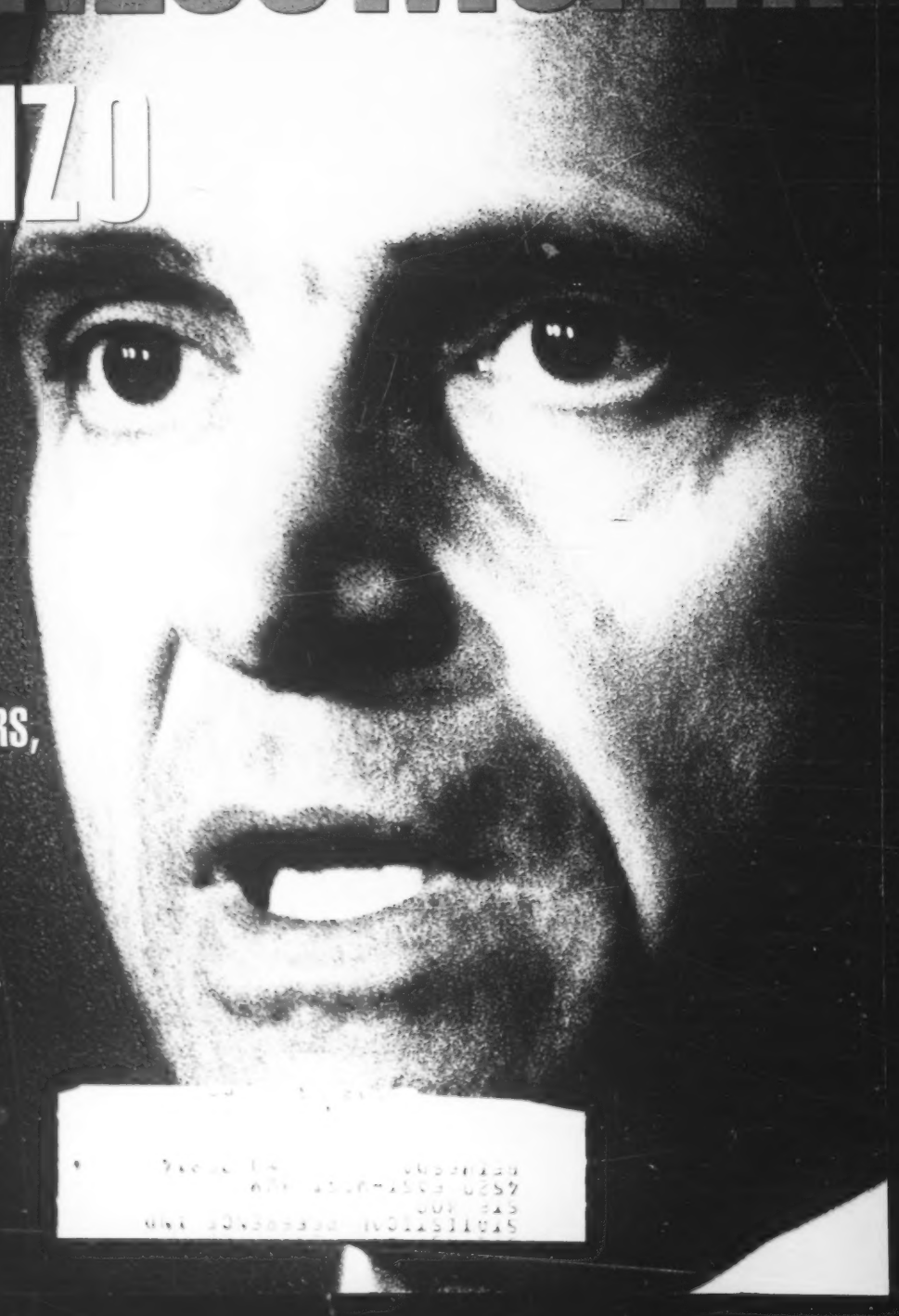
BUSINESS MONTH

LORENZO
AND THE MYTH OF TEXAS AIR
By Michael Ennis

HERE COMES BIG LABOR AGAIN
By A.H. Raskin

AMERICAN MANAGERS, JAPANESE BOSSES: A VERY BAD MIX
By Leah Nathans



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FROM THE EDITOR IN CHIEF

As BUSINESS MONTH enters its 96th year of publication, having covered the great events of its time, it looks to the future. Corporations from midsize to very grand know that an eye on the short term, an overemphasis on the bottom line, an obsession with the immediate, will not cut it as they, and we, scramble as best we can toward the 21st century. The issues of tomorrow must be defined—some we know, of course; information technology has about it the aura of manifest destiny—and then studied and restudied and applied. The very process of management must be examined and explained. Trends must be discerned, patterns detected in the massive weave of progress. What is real and what is transitory? What is laudable and what is mean? What has value and what is worthless? We will be posing questions as the months and years go by, and trying to supply some answers as to what's ahead in corporate life.

•

Whither Texas Air? And what of Frank Lorenzo, the Green Baron, the Duke of Discounts, the man who took over an airline under perfectly hostile conditions? What will happen on legal, labor and safety fronts? Can Continental get the damned thing off the ground? The very private Lorenzo betrays no great worry, but others—from government regulators to admiring corporate competitors—are concerned indeed about the astonishing range of problems in the vast Lorenzo air squadron. What happens to him may have profound effects on the industry at large.

Lorenzo and the brouhaha concerning Texas Air and all the little Airs is the cover story this month.

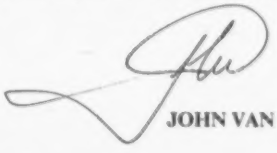
One of those subsidiaries is Eastern Air Lines, formerly run by the ex-astronaut Frank Borman. How he got to be formerly—that is, how the unions and Frank Lorenzo combined to relieve him of his command—is the subject of a book we are excerpting. It's part of the package.

•

In a survey of more than 600 chief executive officers of major American corporations, commissioned last year by BUSINESS MONTH, the "marketing-intelligence" firm of Yankelovich Clancy Shulman turned up this piece of information: Businessmen don't take unions seriously anymore. Concern over power of the unions was far down the list of worries, in fact. Marching ahead were such issues as the federal deficit, government regulation, recession, foreign competition, tax policy, the trade deficit, inflation, quality of middle management.

This odd bit of information nagged at us. Had not labor been the bane of corporate existence for decades? Why the slippage? Was it real? Most important, was it lasting? That is, what does the future hold for the labor movement, and what should corporate America know about it?

No writer in America is better qualified to answer those questions than A.H. Raskin, for many years the labor correspondent of *The New York Times*. He took on the task for BUSINESS MONTH, and his report is startling and provocative. It is a Special Report that should not be missed.



JOHN VAN DOORN

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NORA FELLER

PERSPECTIVE

California's Big Bang

HIGH NOON FOR CALIfornia's insurance industry and trial lawyers will be the first Tuesday of November this year. That is when they face off in a statewide referendum that will leave one or the other seriously wounded. And because California is a large and important market for both groups, any controls placed on insurance premiums or legal fees there will reverberate throughout the loser's industry nationwide.

The shoot-out started when the insurance companies, claiming that too many lawsuits were hurting consumers by driving premiums up, sponsored ballot measures that would forever exempt the industry from the state's antitrust laws and introduce no-fault automobile insurance. But what got lawyers all riled up was an attempt to cap attorneys' fees in all tort cases, including lucrative class-action product-liability suits.

Faced with a significant reduction in their income potential, the state's trial lawyers put together a coalition with consumer groups to fight back, claiming that increased insurance rates are due to insurers' greed. Their ballot counter-initiative mandates an insurance commissioner who would have the power to review and regulate insurance rates and a 20 percent good-driver reduction in automobile insurance premiums to go into effect January 2, 1989. Attorneys' fees, needless to say, will not be subject to any restrictions. "freedom of contract" is the watchword here. And if lawyers and consumer advocates aren't strange enough bedfellows, the banking industry has also joined their cause. It seems the initiative allows banks to sell insurance.

—*Larry White*

WHY CALIFORNIA INSURERS SEE RED

While Golden State lawyers campaign for lower insurance premiums, underwriters complain that they're already being nibbled to death by claims and lawsuits. Mounting losses on auto policies tend to support their case.

Year	Auto Premiums* (in billions)	Auto Claims Paid† (in billions)	Auto Insurance Profits and (Losses)* (in millions)	Auto Related Lawsuits‡
1982	$4.6	$3.1	$69.2	50,180
1983	$5.0	$3.4	($25.9)	51,560
1984	$5.6	$3.8	($30.5)	55,297
1985	$6.7	$4.4	($68.9)	63,750
1986	$8.2	$5.3	($71.8)	82,258

*Source: National Association of Insurance Commissioners †Source: A.M. Best ‡Source: 1988 Annual Report of the Judiciary Council of California. Compiled by Fred F. Jespersen

ROB KINMONTH

What Politicians Do To Survive

JOHN D. ROCKEFELLER and Andrew Carnegie must be spinning in their graves with delight over a program proposed by Lloyd Bentsen, U.S. Senator from Texas and Democratic running mate, as part of the interior appropriations bill. It would exempt oil companies from compliance with federal antitrust laws. The measure is needed, according to Bentsen, so that long-suffering American oil companies can "work together in research on enhanced [oil] recovery," which would in turn improve U.S. energy self-sufficiency by increasing recovery rates from known oil deposits. "Let's do it on behalf of recovery," Bentsen suggested. Of course, the proposal fails to mention whether oil companies would also be working together on such things as pricing and market-share division, which were the types of cooperative activities that got the Standard Oil Trust and United States Steel in trouble with Teddy Roosevelt's trustbusters in the first place.

—*Laurel Brubaker Calkins*

Senator Lloyd Bentsen offers oil companies some relief from antitrust.

Your Wish Is Their Command

NO ONE WAITED MORE eagerly than the business community for the first full session of a U.S. Supreme Court loaded with Reagan-appointed justices, and the 1987–88 term did provide good news—up to a point.

Testing the court's leanings were four cases that read like a business wish list:

- From corporations selling to the government: Don't make us legally responsible for the majority of deaths and injuries caused by equipment we manufacture according to government specifications.
- From companies that run "gray market" discount stores: Allow us to sell imported, brand name cameras, perfumes, watches, automobiles, cosmetics, electronics products and other goods at steep price reductions without interference from the owners of the trademarks.
- From manufacturers: Say we won't automatically violate antitrust laws if we protect our dealers by cutting off supplies to price slashers.
- From employers whose pension plans previously discriminated between men and women: Don't force us to pay tens of millions of dollars to workers who retired before the Supreme Court outlawed sex bias in pension benefits in 1983.

The Supreme Court granted all four wishes, and a key factor was the emerging conservative majority: William H. Rehnquist, the President's choice for chief justice; Sandra Day O'Connor; Antonin Scalia; and Anthony M. Kennedy. They and Justice Byron R. White formed the 5-4 majority in the pension and government contractor decisions.

But the trend, if that's what it is, must be rated shaky at best. The conservative majority remains narrow, fragile and shifting. In the 5-to-4 "gray market" decision, for example, the winners were dis-

SKY KING

Frank Lorenzo built the world's biggest airline company on reckless price cutting, government aid and lots of debt. He will need a miracle to keep it flying.

BY MICHAEL ENNIS

When Frank Lorenzo, the wiry, reserved chairman of Texas Air Corporation, confronted a Washington news conference in June, he was smiling at circumstances that would have wiped the grin off most CEOs' faces. True, Texas Air's two key subsidiaries, Eastern and Continental airlines, which together comprise the free world's largest commercial airline fleet (650 aircraft), had just passed an unprecedented investigation by the Department of Transportation into its safety compliance and fiscal fitness. But that was the only bright spot in a gathering storm. The department had added an important caveat to its report, warning that Eastern's troubled labor-management relations could cause serious safety problems in the future; the U.S. House of Representatives had a resolution in the works that would continue scrutiny of Texas Air; and House Aviation Subcommittee members hinted they might disagree publicly with some of the DOT's conclusions. Eastern's unions already had, calling the report a "whitewash," and financial analysts pointed out that the DOT, which described the figures it used as "optimistic," had glossed over the liquidity crunch. Finally, beyond the purview of the investigation was the long-term outlook: Lorenzo's $8.4 billion air empire was so deeply in hock it would need at least a billion dollars this year just to service its debts.

It is easy to assume that Lorenzo, long the recognized standard-bearer for the free-market conquest of the aviation industry, wouldn't have it any other way. He has been credited—not always accurately—as the first airline chief to offer discount fares, the first to attempt a hostile takeover of another airline and the first to take a solvent airline into bankruptcy to abrogate onerous labor agreements. An undisputed wizard of leverage and a relentless proselytizer for unfettered commerce, Lorenzo has become not only the personification of airline deregulation but also a bankable superstar among '80s business celebrities.

Unlike many of his fellow corporate luminaries, Lorenzo, the man, has remained

PAUL FUSCO/MAGNUM

LEGEND DESCRIBES LORENZO AS A RUTHLESS APOSTLE OF ECONOMIC DARWINISM.

a mystery; he rarely grants interviews and has steadfastly refused to answer personal questions. When he does reveal himself, it is in a curiously utilitarian fashion: He wants to be seen as a lean and hungry cost cutter, for example, so we learn that he competes in marathons; he protests that he isn't a union buster, so we hear how he put himself through Columbia University as a rank-and-file Teamster; he wants to charm disenchanted employees, so we are informed that he is a family man, with a wife, four children and a relatively modest home in a Houston suburb. Such a lusterless mosaic of the private Lorenzo suggests that we aren't missing much by being denied more intimate particulars.

More is known about the public man, but here, too, reality is obscured—by business-press hyperbole, Wall Street wish fulfillment and union propaganda. The Lorenzo legend—like his debt—has been rolled over for so many years that the myth now conceals history. The businessman we see is a caricature in black and white, a hard-charging, freewheeling, ruthlessly efficient apostle of economic Darwinism, but beneath the accretion of clichés is a gray, tentative figure who has never flourished in straight-up deregulated competition and has been kept aloft by the very courts and government agencies whose control of the aviation industry he has so often disparaged.

The opening chapter in any standard hagiography of Frank Lorenzo is the resurrection of Texas International Airlines. By the summer of 1986, after Lorenzo had commandeered Eastern, brought Continental out of bankruptcy and boosted Texas Air stock to $51.50 a share, Texas International had been canonized as his first certified miracle. And it is here that we begin our search for the man behind the myth. To understand how Lorenzo really works—and why his Texas Air empire doesn't—requires a closer examination of the litany of Lorenzo miracles.

Francisco Anthony Lorenzo was born in Queens, New York, to parents who had emigrated from Spain as children. He received an MBA from Harvard in 1963 and put in a couple of years as a financial analyst for Trans World and Eastern airlines. In 1966 he and Bob Carney, a Harvard classmate, formed Lorenzo, Carney & Company, a consulting firm that matched Wall Street financiers with needy airlines. Three years later, they incorporated an aircraft-leasing business called Jet Capital, but by the time they were able to get the company up to speed in early 1971, two years of recession had dampened the aircraft-leasing outlook. The best investment opportunities in aviation turned out to be small regional airlines, which had suffered even more from the economic downturn than had the major trunk lines.

Jet Capital, flush with $1.5 million in cash raised through a public offering of common stock and warrants, made a run at Mohawk, a carrier based in Utica, New York, and failed. Then Chase Manhattan Bank, chief lender to Texas International, dropped that company into Jet Capital's lap. The bank had summoned Lorenzo and Carney to Houston as $15,000-a-month consultants to come up with a plan to save the struggling carrier. Formerly Trans-Texas Airways, TI was based in Houston and had routes throughout the Southwest. Despite later, myth-building characterizations of pre-Lorenzo Texas International as a chewing-gum-and-baling-wire operation, what Lorenzo found when he looked it over was "basically a very good route structure, good people and good equipment." In fact TI had done well enough in the 1960s to have committed the cardinal sin of airline management: overoptimistic expansion. With a fleet of 15 new DC-9s and a whopping debt service to match, the airline wasn't prepared for the slump that settled over the industry from 1969 through 1971 and lost a total of close to $20 million.

Lorenzo and Carney's solution took the form of an investment package whose main elements were classic Lorenzo: leverage and control. Building around Jet Capital's $1.5 million in cash, they put together a $35 million equity-financing plan that would give Jet Capital 24 percent of Texas International's stock and 58 percent of its voting power. The plan was approved by the shareholders, and in August 1972 Frank Lorenzo was elected president and chief executive of Texas International. He had virtually no experience in day-to-day airline management, but he had taken over at an unusually propitious time. The outlook for regional airlines had improved dramatically toward the end of 1971, and strong industry-wide gains would be registered throughout the rest of the decade. On top of that, in February 1971 the Civil Aeronautics Board voted to double the $24 million in annual subsidies it was paying nine regional airlines for their losses on unprofitable short-haul routes. Even as the profit outlook improved, the CAB continued to pay the vastly increased subsidies. By the time the agency decided to suspend Texas International's payments after fiscal 1978, the airline, which had made a total of $20 million in net profits until then, had received about $50 million from the CAB. Almost half of Texas International's return was due to the subsidies, according to the agency's computations. Of course, those were the rules everyone played by under regulation, at least until the CAB began to encourage Lorenzo to break them—by discounting prices—at the same time that it was, in effect, paying him for playing fair.

Texas International earned modest profits in 1973–74, then weathered a three-month shutdown when ground and air crews struck in the winter of 1975. Since industry strike-aid payments kept the airline afloat at the break-even point, Lorenzo took advantage of the hiatus to prune unprofitable routes, trim his work force and move his debt balloon a few more years down the road. TI emerged from the labor strife stronger than ever, with three boom years for the industry and a burgeoning Sunbelt economy still ahead. The only cloud on this horizon was Southwest Airlines, an upstart intrastate commuter line founded in 1971. Regulated by the state of Texas instead of the CAB, Southwest could operate virtually like today's deregulated airlines, setting its fares and selecting its routes without waiting for the board's approval.

Texas International got enough action to turn a $3.2 million profit in 1976, but it still needed a competitive edge against Southwest, which was using its low fares and exclusive landing rights at Dallas's close-in Love Field to lock up the lucrative Dallas-to-Houston route. Lorenzo turned to his benefactor, the Civil Aeronautics

Michael Ennis is a free-lance writer in Dallas, Texas.

AP/WIDE WORLD

SAFETY QUESTIONS THAT WON'T STOP

The Department of Transportation's report on Texas Air, released in June, was mostly a relief for the embattled airline company, but it fell short of providing the flying public with a definitive answer to the crucial question: Is it safe to fly with Frank Lorenzo?

A Federal Aviation Administration inspection of the Eastern and Continental fleets conducted over a 30-day period in the spring did answer part of the question. These so-called ramp inspections, which involved a 25- to 45-minute look inside and outside every aircraft and an examination of the maintenance logbooks, supplied the raw data for the DOT's investigation, and the rulings were basically favorable to Continental. None of its aircraft was grounded as result of the ramp inspections, although a fifth of the fleet—not an unduly large number—was voluntarily removed from service until various maintenance problems, mostly minor, were attended to.

Although Eastern had, in the FAA's own words, "a history of significant noncompliance" before Texas Air acquired it—the airline was slapped with a record $9.5 million fine after dozens of airworthiness violations were uncovered in a 1985–86 inspection—under Lorenzo's aegis, spending on maintenance had actually increased to a level well above the industry average, and an FAA inspection last year showed considerable improvement in safety compliance. Still, serious problems did remain. Eastern voluntarily removed a third of its fleet from service as a result of the ramp inspections, and the FAA concluded that quality assurance at Eastern's 28 line-maintenance facilities was "almost nonexistent."

The real danger for Texas Air, it seems, arises from the continuing labor problems. A team of six FAA executives conducted a separate inquiry into labor-management relations this spring and reported "a strong concern about the present labor-management culture inside the company and its potential impact on safety." Their report led to arbitration by former Labor Secretary William Brock and an agreement in early July between Eastern and its unions to separate safety issues from the vitriolic dispute over wages.

But even a significant improvement in an atmosphere Brock described as "poisoned" may not be enough to allay long-term concerns. An airline's safety ultimately rests in the hands of its mechanics and pilots, who not only approve or reject aircraft for service on a daily basis, but also provide crucial on-the-job instruction to their less-experienced colleagues. Eastern's pilots are leaving at almost three times the industry average, many of them senior flight officers taking early retirement to lock in their pension benefits, and mechanics, who can easily find better wages elsewhere, are exiting even faster.

Continental has lost personnel at a rate almost as troubling as Eastern's, but the airline has attempted to deal with the shortage through an innovative program that starts pilots at its regional "feeder" subsidiaries, then moves them up, seniority intact, to the big jets when they have the requisite hours. Even so, according to John Bradley, director of organizing for the Airline Pilots Association, many of Continental's regional pilots are sacrificing their seniority and moving to other airlines once they are qualified. There is speculation in the industry that the shortage at Continental may have already contributed to tragedy. The only fatal accident involving a Frank Lorenzo-controlled airline occurred last November in Denver when a Continental DC-9 flipped while taking off in a snowstorm, killing 28 people. The copilot, a 26-year-old with fewer than 40 hours of flying time in DC-9s, was at the controls. However, the National Transportation Safety Board will not rule on the official cause of the crash until September 13.—M.E.

Board, and asked for permission to reduce fares by 50 percent on certain low-density flights to 11 cities. If he couldn't undercut Southwest in Dallas and Houston, perhaps he could undercut his regulated competition on interstate routes. As it turned out, Lorenzo's request, which threatened the very foundations of the carefully constructed edifice of airline regulation, was exactly what the CAB wanted to hear.

John Robson took over as head of the CAB in 1975 with the singular objective of putting the regulatory agency onto a self-destruct heading that would culminate in a free-market airline industry. He and his young staff believed with almost evangelical fervor in the elasticity of the air-travel market: Lower fares brought about by free-market competition would release a stampede of consumers who had previously found flying prohibitively expensive. The vast new market would fill empty seats, and the industry would rake in higher profits in spite of reduced per-passenger revenues. When Lorenzo appeared with his request for discounted fares, the elasticity theory suddenly had its first test case. He got approval in less than two months.

Texas International marketed its new discount rates as "peanuts fares," and the success of the pricing strategy seemed immediately to confirm the deregulationists' forecasts. One flight between Albuquerque and Los Angeles, only 30 percent full at $76 dollars a ticket, filled 90 percent of its seats at half fare, lifting revenues on the flight by 75 percent. Within months the Civil Aeronautics Board extended its permission for peanuts fares to additional markets. With a CAB subsidy in one hand and a CAB dispensation to explore the free market in the other, Lorenzo and Texas International earned more than $20 million over the next two years.

The peanuts fares might have remained a footnote in aviation history had Lorenzo not announced, in the summer of 1978, that Texas International had bought 9.2 percent of the stock in National Airlines, a major trunk carrier based in Miami. Lorenzo's airline wasn't the first to covet National; Pan American World Airways, seeking domestic feeder routes for its international flights, had secretly approached National earlier in the year. But Lorenzo, who eventually acquired almost 25 percent of the company's stock, was the first to openly declare his intentions and receive the accompanying publicity. Even when Pan American beat him out after a year of dickering with the CAB and National's management, the brash Lorenzo came off like a winner for simply making the challenge. Texas International made a pretax profit of $46 million when it sold its shares in National to Pan American in the summer of 1979. Of TI's impressive $41 million net income that year, less than $7 million was accounted for by actual profits from operations.

Although the CAB would not allow unrestricted entry to domestic routes until the end of 1981 and would not eliminate all price restrictions until January 1, 1983 (the agency terminated itself exactly two years later), its acquiescence on the National-Pan American merger signaled to America's airlines that they had better begin preparing for the coming fury of free-market competition. There was considerable confusion, however, about what form the new airlines should take to compete effectively in the deregulated skies. Briefly in vogue was the "upstart" theory, which held that such small, never-regulated airlines as Southwest would quickly outmaneuver the lumbering, regulation-configured major trunk carriers. Lorenzo tested

BANKRUPTCY ALLOWED LORENZO TO FIRE ALL OF CONTINENTAL'S 12,000 EMPLOYEES.

this thesis in 1980 by creating nonunion New York Air, which consistently lost money for the next six years as it tried to compete with Eastern's New York-Washington shuttle.

More enduring was the countervailing "two airline" theory, which had been tossed about for years by the academicians at the CAB. In this world, the big would indeed get bigger, gradually gobbling up those airlines that could not obtain a competitive "critical mass." The ultimate extrapolation would lead to an industry made up of two ultra-efficient leviathans going toe-to-toe, although an industry with five or six major carriers—the situation that exists today—would also validate the theory.

Lorenzo eventually opted to get big. In September 1979 he had as much as $100 million in cash from the sale of National's stock and the issue of more than $50 million worth of equipment-trust certificates secured by Texas International's aircraft. Eager to use his purchasing power, he invited Trans World Airline's chairman, Edwin Smart, to breakfast at the Hotel Carlyle in New York and offered to buy TWA, which was 10 times the size of Texas International. The enraged Smart stalked out without eating. Lorenzo was undeterred by the rebuke; he knew there were plenty of airlines to choose from.

Texas Air Corporation, which was formed in June 1980 as a holding company for Texas International and New York Air, purchased a 9.5 percent interest in the stock of Continental Airlines, the nation's 10th largest carrier, in early 1981 and announced that it intended to make an offer for a controlling interest. The takeover was complicated by the attempts of Continental's employees to buy the company. (Lorenzo's establishment of nonunion New York Air had been a red flag for airline workers.) The drama reached a tragic pitch with the suicide of Continental's dispirited president, Alvin L. Feldman, in August 1981.

At the time many observers wondered why Lorenzo wanted an airline that had lost $55 million in the preceding 18 months, but his two extant carriers were going nowhere—Texas International lost $34 million in 1981—and he needed to make a move. Continental, even with its losses, was a "premier service" airline (Chivas Regal scotch was served in economy class) with a good reputation among business travelers, a market that TI, with its leisure-oriented route structure and sloppy service, had never been able to tap. If there was any kind of industry-wide upturn, Texas Air could combine the two airlines into a profitable critical mass.

It was not to be. Although the major airlines struggled in 1981 and 1982, most were able to contain their losses in the latter year and build on a strong upward surge in 1983 to record profits in 1984. For Texas Air, on the other hand, the situation went from bad to worse. Texas International was merged into Continental in 1982, and the new team generated more than $100 million in operating losses.

Lorenzo, not without cause, blamed high labor costs for his difficulties. Flight attendants—who were averaging $39,000 a year in wages and benefits—and pilots offered $80 million in concessions, but Lorenzo wanted more and set a September 19 deadline for an agreement on an additional $150 million from the workers. It wasn't an environment that encouraged a lot of self-sacrifice. A number of Lorenzo's new management elite were the same young ex-CAB staff members who had formulated deregulation theory, and they had little patience with real world impediments to their sophisticated ideology. Five days after his ultimatum, Lorenzo announced that the airline was filing for reorganization under Chapter 11 of the federal bankruptcy law.

The Chapter 11 filing was a huge success. Lorenzo fired all 12,000 employees, then invited 4,000 back at anywhere from 40 percent to 60 percent of their previous wages. With both the airline industry and the economy still struggling, most of them returned. When the Airline Pilots Association struck the airline a few days later, many pilots crossed the picket lines and eventually voted to forgo representation by the union altogether. Within three days of the filing, Lorenzo's scaled-down "New Continental" was flying again, offering $49 fares for any nonstop domestic flight.

It appeared that Lorenzo had created a formidable deregulation flying machine. Since labor costs had been cut by more than $250 million a year and were now the lowest in the industry, Continental could offer lower fares than any of its major trunk competitors, most of whom cut back on their schedules after growing weary of trying to match the discounted fares. Continental's flights were so glutted that the bankrupt airline had to order dozens of new jets.

The new Continental flew under Chapter 11 for three weeks short of three years and earned more than $150 million in total profits during that period. When the carrier emerged from bankruptcy, it was operating a fleet of 147 aircraft versus 105 three years earlier. Here was conclusive proof of market elasticity. Unfortunately, there was a billion-dollar glitch in the equation—exactly the amount of the interest payments and long-term debt maturities that had been deferred while Continental financed upward of a billion dollars' worth of new planes. As long as it was protected from its creditors, the airline could make money. If it had been obligated to service its debts, it would have been a major loser during a period when the rest of the industry showed record profits. Nevertheless, Continental's emergence from Chapter 11 was widely hailed as another Lorenzo miracle.

Since it was clear to anyone who could read the balance sheets that Continental wasn't competitive outside the bubble of Chapter 11, Lorenzo began working to build a "mega-carrier," to use his own term, well before the airline emerged from bankruptcy. In the summer of 1985, Texas Air made another bid for TWA. Again unions played a critical role in Lorenzo's negotiations, this time by siding with Carl Icahn, who wound up with the company. Unfazed as usual, Lorenzo turned his sights on the only airline whose unions so despised their own president that they would actually prefer Frank Lorenzo: Eastern and Frank Borman (see "Showdown in Miami," p. 39). In February 1986, Texas Air nailed down a $640-million deal to acquire Eastern, its fleet of 300 aircraft, and its System One computer reservation operation—a crucial tool for deregulation-era fare juggling. The price was generally regarded as a steal; Eastern's cash balance of $463 million was more than Texas Air's cash outlay. But Eastern was also heavily in debt, with more than $3 billion in obligations. (Its alarming 87

percent debt-to-equity ratio was still less than Continental's post-bankruptcy 95 percent.) In the week following the deal, Texas Air stock climbed from $17 to $28 a share.

The acquisition of Eastern did not help Continental gain critical mass after all, because to merge the two airlines would permit Eastern's unions to bargain for Continental's nonunion employees. So Lorenzo still needed an ideal mate for Continental, and he found it in People Express, the nonunion, employee-owned discount airline founded by Donald Burr, a former Lorenzo lieutenant. The airline had been battered into bankruptcy by Chapter 11-assisted Continental. In September 1986, Burr grudgingly accepted Lorenzo's offer for People Express and its subsidiary, Frontier Airlines. Texas Air picked up 110 planes, about 1,000 nonunion pilots and $750 million more in long-term debt.

After absorbing People Express and Frontier, Continental, with its fleet of 352 planes, became a bona fide mega-carrier. The overall Texas Air strategy was for Continental, with its low nonunion costs, to drive company earnings while Lorenzo attacked Eastern's high labor bill. Eastern's unions were a notoriously tough bunch, but Texas Air's management felt they could be tamed by the threat of transferring Eastern's planes, routes and jobs to Continental, whose success would be the big stick against Eastern's unions.

The plan immediately went awry. Texas Air had formulated virtually no plans for the merger of "cheap frills" Continental and "no-frills" People and was surprised to find that many of its new employees were unable to handle jetways or operate reservations and ticketing computers. Behind the scenes, planes went wanting for spare parts, and the 13 different types of aircraft now operated by Continental made a farce of the standardization procedures necessary for mega-carrier efficiency. Texas Air exacerbated the inherent problems by frantically shifting managerial personnel in the midst of the crisis. Employee morale, which had remained relatively high through the Chapter 11 period, now plummeted, and Continental's pilots began to leave at twice the normal industry rate, adding to the work load of the remaining aircrews. The Department of Transportation collected record numbers of consumer complaints, and the airline lost $40 million in the first quarter of 1987 on the way to dropping $258 million for the year. Eastern, by contrast, showed a second-quarter profit of $27 million.

Confronted with the collapse of its original strategy for bringing Eastern's unions in line, Texas Air embarked on a plan designed to increase Eastern's liquidity in the event of a strike by members of the International Association of Machinists, whose contract expired last December 31. Eastern's unions countered that Lorenzo was deliberately dismantling the airline. Whatever the intent, Texas Air took the computer reservation system off Eastern's hands for a $100 million note at 6.5 percent, sold 20 aircraft, put an additional 21 on the market and drew more than $100 million in cash out of Eastern through a variety of questionable transactions, including a "strike readiness" fee of $22.5 million paid to Continental and the inexplicable sale of $25 million worth of unsecured notes in bankrupt People Express to Eastern. The boldest stroke was the proposed acquisition by Texas Air of Eastern's venerable Washington-New York-Boston shuttles—believed to account for one-third of the airline's total operating profits—for $225 million. After a court fight with the unions and awaiting arbitration of Eastern's labor problems, Lorenzo backed away from the shuttle deal shortly after the DOT report was released.

Continental, meanwhile, continued to underperform even the stripped-down Eastern, losing a stunning $80 million in the first quarter of this year compared with $64.5 million at Eastern. The Transportation Department's auditors found that Texas Air's own revised cash-flow projections for Continental would be "substantially less than anticipated," while Eastern's would be higher. But amid all the smoke at the Eastern front, few people bothered to ask the salient question about Frank Lorenzo's air empire: Why can't Continental make money? The ultimate deregulation flying machine Lorenzo says he could build at Eastern—if only his unions would play fair—already exists, and it isn't getting airborne.

Continental's problems start at the top, in a Byzantine corporate structure that offers Lorenzo and Texas Air's managers control without responsibility. The leverage situation is one of the wonders of modern finance: The tiny Jet Capital, privately held by a handful of shareholders, with Lorenzo controlling a slight majority, owns just 3 percent of the equity in Texas Air but, through a special class of stock, maintains 34 percent voting control and the right to elect seven of Texas Air's 11 directors. Texas Air in turn manages more than 20 subsidiary corporations, ranging from Texas Air Fuel Management Inc., which sells fuel to all of Lorenzo's airlines, to Continental Airlines Inc. with its collection of small feeder airlines and the corporate vestiges of the companies it has absorbed. (Texas International, New York Air, People Express and Frontier no longer exist as independent carriers.)

Texas Air is not a particularly doting parent. While the corporation likes to arrange the financing for its subsidiaries, it prefers that they guarantee and service most of the debt acquired for them. As a consequence, Texas Air's own corporate debt service will run to only $82 million this year. The parent company has been accused by its unions of "upstreaming"

THE UP SIDE OF DEREGULATION

Frank Lorenzo's problems aside, deregulation has lived up to many of its advocates' predictions. There are more airlines, more passengers, bigger profits and lower fares. Whether these positive conditions survive the growth of such mega-carriers as Continental may depend on how truly competitive the deregulated market remains. And whether the discounters, such as Lorenzo, can stay airborne in it.

	BEFORE DEREGULATION* (In 1988 dollars)	AFTER DEREGULATION**
Number of airlines	36	78
Total annual industry revenues	$19.9 billion	$57 billion
Total annual industry profits	$908 million	$2.5 billion
Average number of planes per airline	55.3	47.1 (1986)
Total passengers	240 million	447 million
Average annual wage for pilots	$85,213	$80,196 (1986)
Average hourly wage for machinists	$17.00	$19.15
U.S. tax dollars paid in direct aid	$72 million	$28 million
Number of airlines that failed	5 (1979)	12
Percentage of seats filled	49.6 %	54.7%
Lowest round-trip fare, NYC to LA	$431.25	$258
Lowest round-trip fare, NYC to Des Moines, Iowa	$332	$168
Number of flights daily from NYC to LA	29	47
Number of flights daily from NYC to Des Moines	4	5

*Annual figures are for 1977 and 1978, unless noted. **Annual figures are for 1987 and 1988, unless noted.

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cash in the form of management and service fees charged its subsidiaries. Some of the accusations, despite Transportation Department waffling on the question, seem justified. Texas Air Fuel Management purports to offer Texas Air's carriers the benefit of large-volume fuel purchases, but Continental and Eastern have been charged more in fees than they save by buying their fuel from Texas Air Fuel.

Undisciplined management also keeps Texas Air from achieving the operational efficiencies supposedly available to a mega-carrier. Lorenzo has in the past boasted about his "eclectic" style of management and the freedom he offers his lieutenants to set their own hours and make their own decisions. But airlines, which require intense day-to-day supervision to eke out the extremely marginal returns on their enormous revenues, are probably not the best place for free-spirited executives. Texas Air may have too much managerial entrepreneurship for a business that is fundamentally very conservative, whatever notions one may have about the romance of flight.

Nonunion Continental also suffers from too little labor entrepreneurship. While low wages have enabled the airline to halve its labor costs compared with some of the other mega-carriers, a dispirited work force can exact a severe economic penalty in the airline business, and not simply because harried flight attendants and grouchy ticket agents are the worst form of consumer relations. "Pilots think of themselves as management," says George Hopkins, a professor of history at Western Illinois University and author of a book about the Airline Pilots Association published by Harvard University Press. "They routinely perform such management functions as deciding which approach path will save the most fuel." The same can be said of mechanics, who regularly make independent judgments that can add up to enormous profit or loss margins in the micro-managed economy of daily airline operations. No upper- or mid-level management team, no matter how creative their cost cutting, can overcome the cost disadvantage of on-line employees who feel little allegiance to the company they work for. Lorenzo's jugular attacks on labor may have been penny-wise and pound-foolish.

The real failing at Continental has been a flawed long-term strategy. Executives have paid periodic lip service to recapturing the business travelers turned off by the airline's poor service and low reliability. Yet every time Continental finds itself in a competitive situation, the reflexive response is to beat the competition on price, not performance, and hope that market elasticity will fill seats with discretionary passengers who otherwise might not have flown on any airline. In the high-flying days of 1986, Philip Bakes, president of Eastern, blithely referred to airline service as "a commodity. We're trying to build some value into it. But no matter what you do, brand loyalty will decline, and price and frequency will be the dominating forces." In the midst of Continental's massive merger woes in early 1987, the airline introduced its Max$aver fares, a full 40 percent lower than its competitors' "supersaver" fares, and the marketplace quickly exposed the limits of elasticity. Traffic did not increase enough to offset the revenue losses.

The marketplace has also assailed the deregulationists' predictions about the importance of service and image to air-travel consumers. The two most profitable airlines throughout the deregulation era have been American and Delta, both of which have relatively high labor costs and are perennial winners in customer satisfaction. American is so confident that passengers will pay extra for superior service that last fall it began to experiment with "two-tier" pricing at the discount end, offering higher fares than its competitors. As for brand loyalty, when Delta was plagued by a string of in-flight mishaps last year, there was not even a short-term decline in its bookings.

For all its problems, Lorenzo's air empire may still be saved, probably through continued sales of Eastern's assets (or perhaps what is left of the whole company, although its marketability is questionable without the computer reservation system) and, more important, the connivance of deregulation's ultimate irony: a deregulated market that is starting to look very much like the regulated market. Many major "hub" cities are now dominated by one or two mega-carriers, and the limited number of gates and landing slots—publicly financed facilities that the airlines are now permitted to own and dispose of as private property—precludes the entry of new competitors. Many experts believe that a new era of oligopoly pricing is already at hand, and the rising fares may save Lorenzo from his deregulationist pricing orthodoxy. But even to compete in such a cosseting environment, Lorenzo will have to stop whining about labor, get his managerial house in order, and formulate a pragmatic long-term strategy to make a winner out of Continental, the airline that deregulation built. If the real Frank Lorenzo, who has performed few of the prodigies attributed to his mythical alter ego, can make Continental fly, he will have performed his first real miracle. ■

A MATTER OF CONTROL

American executives in Japanese companies are well paid, but they so often lack real authority that many quit in despair. That bodes ill for Japan's U.S. strategy.

BY LEAH NATHANS

Late on a Friday afternoon in April 1987, Edward A. Neubauer, senior vice president of sales and marketing at NEC Electronics Inc., walked into the Mountain View, California, office of President Hideo Nakao and announced that he was suing the company for $18 million. It seemed a shocking move. From all appearances, Neubauer was a loyal and valuable member of NEC's senior management. In six years with the company, he had played a leading role in its drive to dominance in the U.S. semiconductor market—an achievement that earned him a seat on the board of directors.

According to Neubauer, however, his ostensibly fast-track career at NEC had become a sham: Instead of being given a promised promotion and raise, his authority had been stripped away as the company's Japanese management took increasing control. His lawsuit (see box, page 52) charges NEC Electronics and its parent, Japan's NEC Corporation, with breach of contract and other violations of California and federal laws. "Professionally, I was used," he says. "I set up the sales and marketing organization, the contacts with major customers and taught the company how to conduct business. Once I did that, my usefulness ended."

Worse was the damage to Neubauer's career. He was fired five months after suing NEC and is still unemployed. "I'm 46 years old and will probably never recover," he says. "I put my confidence in NEC at a time when I was getting offers left and right. They took the most productive years from me. I absolutely trusted these people, and they lied to me. Now all of a sudden I'm switched to a side track, watching all the express trains go by. They have devastated my career."

The Neubauer lawsuit and a handful of others like it are finally bringing to the surface the long-simmering conflict between American executives and their Japanese bosses. There are now an estimated 25,000 American managers working for Japanese companies in the United States, and by and large they seem to be an unhappy and demoralized lot. The Japanese need American executives' expertise to sell their products in the United States and are willing to pay top salaries to get them. But in company after company, the Americans complain about a system of subtle and debilitating discrimination in which they are treated as necessary but inferior outsiders—without the authority to get things done and lacking upward mobility. Their views, as well as those of a number of experts, make it clear that Japan's vaunted management methods, while generally successful on the factory floor, are a dismal failure in the executive ranks.

QUALITIES SUCH AS INDEPENDENCE, AMBITION AND RISK TAKING ARE FROWNED UPON.

This is hardly surprising, given the chasm that separates the American and Japanese corporate cultures. The qualities admired in American managers—ambition, risk taking, independence—are handicaps in Japanese companies, where group cooperation and a strict decision-making hierarchy prevail. Japanese managers generally choose a company for life, and they move up the corporate ladder very slowly and according to seniority rather than ability. Regimented in a multilayered management structure, they are known for working long hours and piling up years of unused vacation time. Japanese companies have been described as Machiavellian bureaucracies where absolute loyalty is demanded and where one wrong political move can ruin a career—dumping a promising manager into what the Japanese call the *madogiwa-zoku* (the by-the-window tribe).

As a result, the Japanese have a hard time dealing with the mobility of American executives, whose tendency to move from company to company to take advantage of better opportunities makes their loyalty automatically suspect and breeds distrust. "The Japanese think of Americans as mercenaries willing to move for money, and who will trade on connections and hand over whatever experience they have acquired at an American company," says Diane Simpson, president of Simpson International, a New York consulting firm that designs cross-cultural training programs for Japanese companies.

Added to that, American managers have to contend with the traditional xenophobia of the Japanese and their belief in their own superiority. Echoing the sentiments of a number of executives interviewed for this article, an American who heads a division in a big Japanese industrial company says that the company's Japanese president will never respect him as an

ILLUSTRATIONS BY RAFAL OLBINSKI

equal because he doesn't meet the three necessary requirements: "I wasn't born in Japan, I didn't have Japanese parents, and I wasn't educated in Japan."

"The Japanese are deeply convinced that their way of doing things is better," says Thomas K. McCraw, a professor of business administration at the Harvard Business School and editor of a book on U.S.-Japan economic rivalry. "They're like the British in Victorian England, who figured we're so good at it, there's no point in arguing."

The basic problem is control. Relative newcomers at managing multinational companies, the Japanese run their U.S. subsidiaries not as separate operations but through vertical lines of authority that stretch across the Pacific at every management level. The subsidiaries have a very low level of autonomy, says Clyde V. Prestowitz Jr., a former counselor for Japanese affairs at the U.S. Commerce Department, and critical decisions, whether in pricing, production, personnel or finance, are made in Japan.

Japanese managers seldom report to an American. And every American manager has a Japanese counterpart—or "shadow"—who officially serves as the communications liaison with the company in Japan but whose real job is to watch over the American and get headquarters' approval for decisions made. A study on the organization of Japanese subsidiaries in the United States by The Boston Consulting Group shows that while the formal corporate chain of command includes American executives at the second or third level, the actual decision-making system cuts out the Americans altogether.

"You have a situation in which business is conducted at night on the telephone in Japanese between Japanese," says Kazuo Nomura, who is counsel for The Boston Consulting Group and helped put the study together. "They come back in the morning and tell the Americans what has been decided, and sometimes they even make it seem like the Americans made the decision."

"The shadow system has been in place in every Japanese company I've been with," says J. Paul Michie, an American who has held high-level executive jobs with both Panasonic and Toshiba and is now a consultant at Samsung, a Korean consumer-electronics giant. "In all divisions, the shadow is there, someone who can say, 'This is the way it will be done.' "

Nomura, a Japanese national who was president of Sumitomo Electric Company in New York, believes that the problem starts at the highest level of the subsidiary, with the Japanese president who is not really running the show but carrying out orders made by company officials far from the firing line in Japan. He may disagree with their decisions but does not want to jeopardize his career by making a "mistake." So he is inclined to simply go along rather than do what he knows is best for the local market.

This same mind-set is evident all the way down the line. The Japanese manager's first priority is to maintain a good relationship with his superiors in Japan, since that is what his future depends on. One American recalls that when he was national sales manager for a major consumer-electronics company, he tried to get his Japanese general manager to start making liquid-crystal-display television sets. But the manager's primary concern was landing a good position when he returned to Japan, and the last thing he wanted to do was fight for a new product. Another American says that his Japanese subordinate would try to curry favor back home by ordering large volumes of difficult-to-sell products from the company's Japanese factory.

BUSINESS IS CONDUCTED AT NIGHT ON THE PHONE BETWEEN JAPANESE.

The problem is exacerbated by the Japanese rotation system of posting executives to the United States for three to five years. Hardly has a Japanese executive made headway in understanding the U.S. market and establishing relationships with the company's American managers than he is replaced by someone else, who has to start from square one. "It's like the Romans when they conquered a territory," says the human-resources manager of a Japanese electronics company. "They would leave a puppet government behind, and when their officials started showing empathy for the locals, they would bring them back and replace them with others who were more loyal."

That was much the situation that Edward Neubauer ran into at NEC Electronics. Keiske Yawata, a NEC executive who had studied in the United States and spoke excellent English, took over as president of the subsidiary in 1981 and was determined to make it a true multinational that blended Japanese technological know-how and American management expertise. But by trusting Americans, Yawata lost clout and credibility with the conservative NEC bureaucracy, and he was replaced in late 1984. Neubauer and the American executives whom Yawata had hired kept their titles and positions but lost their authority to Japan, says Robert C. Hinckley, the company's former general counsel. Eventually most of them quit. Yawata also left NEC and now heads the Japanese office of an American semiconductor start-up.

The rotation system not only indicates a lack of commitment to the local market but means that no one is responsible for the long-term success of the American subsidiary, says William L. Everitt, vice president of communications at Kyocera International, a Japanese semiconductor packager. For Japanese executives to have a vested interest in the success of the U.S. subsidiary, he says, "they must be prepared to bury their bones in America."

Also potentially divisive are the separate compensation, benefits and promotion systems for Japanese and American employees. Even in the rare cases when Japanese managers report to Americans, their salaries are fixed in Japan. Donald Moffet, who as president of Fujitsu Systems is one of very few Americans to hold the top post in a Japanese subsidiary, says that he does not determine the salaries or have the right to hire or fire the handful of Japanese nationals on his staff.

American managers caught up in the system pay a high price not only in career damage but in loss of pride and self-determination. The fallout is most evident in industries that are dominated by the Japanese, such as consumer electronics. Paul Michie spent 10 years at Panasonic, where he was a group vice president, and later went to Toshiba as an executive vice president. He says that American managers who invest their careers in the industry "have little choice but to keep their heads down. It's possible to be a strong manager within limits, but I wouldn't bet on your longevity. If they want to drive you into the ground, it doesn't matter if you are right or wrong. Ultimately, they own the sign over the door. And when you get bounced out of one of these companies, you have to place yourself back in with another."

The inequities in the Japanese system are most evident when business is bad. Only Americans are fired. From the Japanese point of view, this strategy makes

RATING THE JAPANESE EMPLOYERS

Some Japanese companies are trying to Americanize their U.S. subsidiaries—although overall, few American managers wield real power. Here's how 25 of the largest employers stack up:

COMPANY	EMPLOYEES TOTAL	EMPLOYEES AMERICAN	EMPLOYEES JAPANESE	CHAIRMAN/ PRESIDENT	YEAR BEGUN	TOTAL SALES (Millions)	COMMENTS
Matsushita Electric Corp. of America Secaucus, NJ	9,000	8,694	306	Akiya Imura	1959	$4,300	Moving back from American management to Japanese control. Umbrella for Panasonic, Technics and Quasar brands.
Fotomat Corp. St. Petersburg, FL	8,491	8,485	6	Minoru Yoshimura	1967	156	Owned by Konica Corporation since July 1986. Still run as an American company.
SONY Corp. of America New York, NY	7,000	6,800	200	Masaaki Morita	1960	2,700	One of the most Americanized Japanese subsidiaries, due to the influence of its cofounder Akio Morita. Has American president, Neil Vander Dussen.
Fujitsu America San Jose, CA	4,500	4,365	135	Masaka Ogi	1976	1,210	Has active program to Americanize and has promoted American executives and given them authority. An American sits on the board of directors.
California First Bank San Francisco, CA	3,900	3,845	55	Seishichi Itoh	1953	6,000[1]	Operated as an American bank; 77 percent owned by Bank of Tokyo. Three of the top eight executives are Americans.
Canon U.S.A. Lake Success, NY	3,477	3,150	327	Fujio Mitarai	1965	2,200	Highly autonomous. Parent depends on the subsidiary for a large percentage of its profits.
Sanwa Bank California Los Angeles, CA	3,300	3,265	35	Yukihiro Fujiwara	1972	5,315[1]	Operated as an American bank. Seven of the top 10 executives are American.
Toyota Motor Sales, U.S.A. Torrance, CA	3,300*	3,260	40	Yukiyasu Togo	1957	10,200†	American managers in key positions, but Japanese staff advisers exert determining influence on operations and culture.
NEC America Melville, NY	2,700	N/A	N/A	Tadashi Suzuki	1963	885	Traditional Japanese company run from Japan.
American Honda Motor Co. Gardena, CA	2,500*	N/A	N/A	Yoshihide Munekuni	1959	11,000†	Japanese management. Given considerable autonomy as sales arm for U.S. manufacturing subsidiary.
Toshiba America New York, NY	2,400	2,290	110	Nobuo Ishizaka	1965	1,500	Of nine top executives, only two senior vice presidents are American.
Konica Business Machines U.S.A.[2] Windsor, CT	2,311	2,303	8	Sho Kamiisaka	1986	250	Acquired in 1986. Still run basically as a U.S. company. Five of the top seven executives are American.
Kyocera International San Diego, CA	2,300	2,210	90	Kazuo Inamori	1969	450	Has American president and top managers. Traditional Japanese culture blends with entrepreneurial philosophy of Inamori.
Ricoh Corp. West Caldwell, NJ	2,200	2,090	110	Keiji Endoh	1962	973	Five top executives are Japanese. Given considerable autonomy, due to strong U.S. manufacturing presence.
Nissan Motor Corp. in U.S.A. Carson, CA	2,000*	1,975	25	Kazuyoshi Hagiwara	1960	7,697	Import and sales arm. After departure of Marvin Runyon as president of Nissan Motor Manufacturing, both manufacturing and sales returned to tight control by Japanese parent.
Sharp Electronics Corp. Mahwah, NJ	2,000	1,880	120	Toshikazu Mitsuda	1962	1,800	Five of the six top executives are Japanese.
Murata Erie North America Smyrna, GA	1,843	1,820	23	Fred Chanoki	1981	184	Operated as an American company.
Alpha Therapeutic Corp. Los Angeles, CA	1,670	1,663	7	Hachino Ishigaki	1978	172	Acquired by Green Cross Corporation in 1978, which has kept American management.
Sumitomo Bank of California San Francisco, CA	1,650	1,600	50	Keizo Yoshida	1953	2,907[1]	Caters to Asian-American customers. About 60 percent of the employees are Asian or Asian-American.
Bridgestone (U.S.A.)[3] Nashville, TN	1,600	1,577	23	James P. McCann	1967	400	McCann, an American, appointed as president and board member in August. Unclear how Firestone, acquired in May, will be affected by Japanese ownership.
Hitachi America, Ltd. Tarrytown, NY	1,570	1,398	172	Tsuneo Tanaka	1959	1,400	Recently took steps to become more autonomous and promoted Americans to senior level. Tanaka says he wants to appoint an American president.
Japan Air Lines Co. New York, NY	1,411	N/A	N/A	Susumu Ozawa	1953	6,700	Management is mostly Japanese. American managers at the operations level.
Hattori Corp. of America New York, NY	1,268	1,258	10	Tsutomu Mitome	1970	650	Handles import and sales of Seiko watches and Epson printers. Robert Pliskin, an American, is president of the Seiko Time Corporation subsidiary.
Subaru of America[4] Cherry Hill, NJ	1,172	1,169	3	Harvey Lamm	1968	1,800	Import and sales subsidiary. American management has operating autonomy.
Mitsubishi Electric Sales America Cypress, CA	1,107	1,055	52	Tachi Kiuchi	1974	1,160	Traditional Japanese company.

[1]Total assets. [2]Formerly Royal Business Machines. [3]Does not include Firestone Tire & Rubber. [4]Public company, 49 percent owned by Fuji Heavy Industries.
*Does not include manufacturing employees. Toyota, 1,250; Honda, 6,000; Nissan, 3,100. †Estimate.

SEEKING REDRESS IN THE COURTS

Nobody knows how many American executives have lodged complaints against their Japanese employers for discrimination and unjust dismissal, because most disputes are settled privately and the executives involved are required to sign confidentiality agreements. A number of Japanese companies have paid hefty sums to settle such grievances, says George S.L. Dunlop, a partner in the California law firm of Dunlop & Haslam, who has brokered some six-figure settlements.

So far, though, American managers have had a tough time proving their cases in court. Roughly 20 lawsuits have been filed to date, and lawyers involved in such litigation report that they know of no executive who has won. It is very difficult for a manager to prove that he lost his job in favor of a Japanese, says Dunlop.

The odds against victory have not discouraged Edward Neubauer (see story) and Thomas McDannold from suing NEC Electronics, the California subsidiary of Japan's NEC Corporation. In nearly identical lawsuits filed in April 1987, Neubauer and McDannold charged that the company owed them compensation and benefits and that it had required them to break American laws.

Both men were high-level executives at NEC—Neubauer was senior vice president of sales and marketing, McDannold vice president of administration—and sat on the board of directors. According to their lawsuits, NEC Electronics had promised them authority in an autonomous, Americanized company and more lucrative compensation packages as an inducement to stay. Included in Neubauer's filing is a letter from Keiske Yawata, a former NEC Electronics president, agreeing to give Neubauer a base salary of $118,000, a 20 percent to 50 percent annual bonus, vesting in a supplemental executive retirement plan and a $200,000 interest-free loan.

Neubauer and McDannold charge that when they voiced concern about "unlawful" activities by NEC Electronics, they were stripped of authority and their compensation packages were withdrawn in an effort to force them out. They claim that they were asked to discriminate against American employees in favor of Japanese nationals; and that NEC Corporation, the parent company, set up a system of "transfer pricing" in order to return profits to Japan without paying U.S. taxes. The case was scheduled to be heard in federal court in late August. —L.N.

sense; Americans are often paid more than their Japanese counterparts, and they are not integrated into the corporate parent. But it still creates resentment. "When people are laid off, Americans walk the street and the Japanese go home," says Michael K. Young, director of the Center for Japanese Legal Studies at Columbia Law School. "There is no sense of a shared spreading of the burden. There is a sense that we are not being treated fairly."

Take the experience of James A. Ristow, who was head of Toshiba's calculator division when the company decided to get out of the business in 1983. He was told to close down the division and fire 41 Americans, while Japanese employees were transferred to other company divisions. Ristow, a 14-year Toshiba veteran, was the last to be fired. "Americans feel that they are a vital part of the company," he says, "but when push comes to shove, they will not be figured into the equation."

Ristow sued Toshiba for $1.6 million, charging employment discrimination, but lost the case. He says that he was blackballed in the industry after filing suit and considers himself lucky to be working for C.B.M. America Company, a Japanese business-machines subsidiary.

What finally seals the barrier between American and Japanese managers is language. The most infuriating thing to many Americans is the constant side conversations that go on in Japanese, says Clifford Clarke, president of IRI International, a California consulting firm. The Japanese like it that way. One manager at a big Japanese bank says that he signed up for Japanese language lessons only to be told by a Japanese colleague that his efforts were not appreciated. And a Japanese-speaking American who worked for a Japanese financial firm says she was treated like a freak, "a talking dog."

Japanese companies' ineptitude in handling American executives is causing them serious headaches, which are bound to become more severe as they expand their presence in the United States. They are having trouble getting top-quality managers, despite paying higher salaries, and turnover in some industries, including electronics and financial services, is high. American executives rank Japanese banks behind first- and second-tier American banks and first-tier British and Swiss banks in status, according to Windle Priem, a managing director of the executive-search firm Korn/Ferry International. Japanese financial companies in New York, he says, pay up to 20 percent to 30 percent more than prestigious U.S. institutions for junior and middle managers.

Some Japanese companies complain privately that they are getting inferior managers. But ambitious Americans simply leave Japanese companies when their career paths are blocked, says Boston Consulting Group's Nomura, and those who remain are content not to "make waves." Recruiters also recognize that working for the Japanese would be a disaster for some of the best American executives. "I would not put a PepsiCo or a Citicorp guy in a Japanese company," says one. "They are hip shooters who are aggressive, outgoing, strong people."

To be sure, a handful of big Japanese companies have come a long way in Americanizing their U.S. subsidiaries, and progress is evident at a number of others (see table, page 51). But whether the Japanese can master the art of running multinational organizations remains to be seen. Some observers believe they can but that it will take time. "Autonomous local management will take maybe 10 to 20 years," says Richard Kraft, president of Matsushita Electronic Corporation of America. "The Japanese will do it, just as [the United States] did it in France and Argentina and as IBM is doing it today in Japan."

Nomura, for one, is more pessimistic. In his view, Japanese companies stand to lose market share in the United States as competition from other fast-developing Asian countries and U.S. companies intensifies. The key to their success is no longer sales and distribution but marketing, he says, and without local autonomy and expert American management, they are isolating themselves from the consumer. Ultimately, he believes, some of them will fail.

For Japan, such failure would be serious indeed. The United States has been a major source of profits for Japanese industry. And now that the strong yen has forced big auto and consumer-electronics companies to transfer manufacturing operations here, the American market is more crucial than ever to Japan's corporate health. At stake, of course, is the delicate economic and political interdependence of the United States and Japan. There are currently about 600 Japanese subsidiaries in this country, and hundreds more are expected to be set up, either from scratch or through acquisition, over the next five years or so. As the Japanese presence grows, American managers' antagonism toward their Japanese bosses can only fuel protectionist sentiments and jeopardize the U.S.-Japan partnership. ■